



The Municipal Manager
Inxuba Yethemba Municipality
PO Box 24
CRADOCK
5880

30 November 2010

Reference: 21302REG09/10

Dear Sir

Report of the Auditor-General on the financial statements and performance information of Inxuba Yethemba Municipality for the year ended 30 June 2010

1. The above-mentioned report of the Auditor-General is submitted herewith in terms of section 21(1) of the Public Audit Act, 2004 (Act No. 25 of 2004) read in conjunction with section 188 of the Constitution of the Republic of South Africa, 1996 and section 121(3) of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA).
2. We have not yet received the other information that will be included in the annual report with the audited annual financial statements and have therefore not been able to establish whether there are any inconsistencies between this information and the audited annual financial statements and the reported performance against pre-determined objectives. You are requested to supply this information as soon as possible. Once this information is received it will be read and should any inconsistencies be identified these will be communicated to you and you will be requested to make the necessary corrections. Should the corrections not be made we will amend and reissue the audit report.
3. In terms of section 121(3) (municipality); 121(4) (municipal entity); of the MFMA you are required to include the audit report in the municipality's annual report to be tabled.
4. Until the annual report is tabled as required by section 127(2) of the MFMA (municipality and municipal entity the audit report is not a public document and should therefore be treated as confidential.
5. Prior to printing or copying the annual report which will include the audit report you are required to do the following:
 - Submit the final printer's proof of the annual report to the relevant senior manager of the Auditor-General of South Africa for verification of the audit-related references in the audit report and for confirmation that the financial statements and other information are those documents that have been read and audited. Special care should be taken with the page references in your report, since an incorrect reference could have audit implications.
 - The signature *Auditor-General* in the handwriting of the auditor authorised to sign the audit report at the end of the hard copy of the audit report should be scanned in when preparing to print the report. This signature, as well as the place and date of signing and the Auditor-General of South Africa's logo, should appear at the end of the report, as in the hard copy that is provided to you. The official logo will be made available to you in electronic format.

6. Please notify the undersigned Senior Manager well in advance of the date on which the annual report containing this audit report, will be tabled.
7. Your cooperation to ensure that all these requirements are met would be much appreciated.

Kindly acknowledge receipt of this letter.

Yours sincerely


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Senior Manager: ECBU

Enquiries: Daneal Hibbers
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AUDITOR'S REPORT OF THE AUDITOR-GENERAL TO THE EASTERN CAPE PROVINCIAL LEGISLATURE AND THE COUNCIL ON INXUBA YETHEMBA MUNICIPALITY.

REPORT ON THE FINANCIAL STATEMENTS

Introduction

1. I have audited the accompanying financial statements of Inxuba Yethemba Municipality, which comprise, the statement of financial position as at 30 June 2010, and the statement of financial performance, statement of changes in net assets, statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information, and the accounting officer's report, as set out on pages ... to

Accounting officer's responsibility for the consolidated financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and in the manner required by the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA). This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

Auditor-General's responsibility

3. As required by section 188 of the Constitution of South Africa, 1996 (Act No. 108 of 1996) and, section 4 of the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA) and section 126(3)(a) of the MFMA, my responsibility is to express an opinion on these financial statements based on my audit.
4. I conducted my audit in accordance with International Standards on Auditing and *General Notice 1570 of 2009* issued in *Government Gazette 32758 of 27 November 2009*. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
5. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
6. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

Basis for a qualified opinion

Comparative figures

7. The supporting documentation for expenditure amounting to R 4 943 176, that forms part of the total other general expenditure of R16 281 187 as disclosed in the statement of financial

performance comparative figures, could not be verified due to a scope restriction brought about by the non-submission of supporting documentation. This caused us to qualify our audit opinion on the financial statements relating to that year. This has an impact of overstating the prior year expenditure as well as overstating the accumulated losses.

Current misstatements

8. The municipality's repairs and maintenance vote also includes amounts that should have been recognised under the general expenses amounting to R651,284. In terms of GRAP 1 the expenses associated with the main functions undertaken by the municipality are shown separately and thus the municipality would have a separate line item for each of these functions. Management have not strictly allocated each expenditure line item according to the main function.
9. The municipality's leave records were not kept up to date and thus resulted in leave days balances of employees being misstated as the leave that should have been forfeited during the year under review was not correctly accounted for in the municipality's leave records. The leave accruals amounting to R3,155,669 that form part of the trade and other payables as disclosed in the statement of financial position, is overstated by R745,359. This constitutes a departure from SA GRAP as the items should be recognised as liabilities when they satisfy the definitions and recognition criteria for those elements in the Framework (Framework for the Preparation and Presentation of the Financial Statements).
10. Further, the accounting records of the municipality indicate that management has overcharged the public by R686,800. Management had incorrectly applied an incorrect tariff when accounting for the sales of electricity, and thus have not used the rates that have been approved by the energy regulator NERSA. This constitutes a departure from the SA GRAP as the revenue is required to be recognised at fair value.
11. Furthermore, revenue amounting to R641,326, that forms part of the total revenue as disclosed in the total revenue in the statement of financial performance, is overstated due to the revenue not having been recognised at fair value at the transaction date. In terms of GRAP 9 revenue should be recognised at fair value and consequently the difference between the nominal amount of consideration and the fair value is recognised as interest. This constitutes a departure from the GRAP 9 as the revenue is required to be recognised at fair value.
12. As explained in Note 1.3 the municipality is not required to measure property, plant and equipment for reporting periods beginning on or after a date within three years following the date of initial adoption of GRAP 17. This is in terms of Directive 4 issued in March 2009 which grants the municipality an exemption from the measurement requirements of GRAP 17. Consequently the municipality has recognised the property, plant and equipment at provisional amounts. The exemption only applies to the measurement requirements of the standard of GRAP on Plant Property and Equipment and as the municipality is still required to identify all their assets. Management has not identified all their assets as there were a number of assets that belong to the municipality but not shown in the municipal asset register. Furthermore there were a number of assets in the municipal asset register but could not be verified for their existence. This constitutes a departure from the GRAP 17 as the Directive 4 exemption only applies to the measurement requirements.
13. The municipality's accounting records indicate that had the municipality correctly accounted for these items as listed above, the repairs and maintenance would be decreased by R651,284, the total revenue would be decreased by R1,328,126 and the leave accrual would be reduced by R745,359.

Unauthorised expenditure

14. No unauthorised expenditure was disclosed by the municipality in the notes to the financial statements. However, unauthorised expenditure was identified, as the vote for bulk purchases of electricity in the approved budget was exceeded by R420,141.

Irregular expenditure

15. No irregular expenditure was disclosed by the municipality in the notes to the financial statements. However, irregular expenditure was identified, as the municipality did not comply with the supply chain management policy when purchasing goods and services. The non-compliance resulted to an irregular expenditure of R 5,752,580.

Opinion

16. In my opinion, except for the effects of the matters described in the basis for qualified opinion paragraphs, these financial statements present fairly, in all material respects, the financial position of the Inxuba Yethemba Municipality as at 30 June 2010 and its financial performance and its cash flows for the year then, in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) described in note 1 to the financial statements, and in the manner required by the MFMA.

Emphasis of matters

17. I draw attention to the matters below. My opinion is not modified in respect of these matters:

Restatement of corresponding figures

18. Except for the restatement of the corresponding figures due to the GRAP conversion from the IMFO basis of accounting no other corresponding figures were restated.

Budget/Funding discrepancies

19. The municipality has materially underspent its total budget to the amount of R 17.5 million. The most significant under spending relates to the employee costs amounting to R4.1million as a result of vacant posts that had initially been budgeted for.
20. Property rates were underbudgeted with R10 million in terms of section 54(1)(d) of the MFMA, the accounting officer should ensure that the budget is implemented in accordance with the service delivery and budget implementation plan and that the revenue collection proceed in accordance with the budget.
21. Furthermore as disclosed in note 15 of the annual financial statements, there are unspent conditional grants amounting to R9.151 million, where the grant revenues were not fully utilised during the financial period. There were also creditors amounting to R1.8 million which exceeded the payment terms of 30 days as required by the MFMA and which would have impacted on the underspending had they been paid in time.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

22. As required by the PAA and in terms of *General Notice 1570 of 2009* issued in *Government Gazette 32758 of 27 November 2009*, I include below my findings on the report on predetermined objectives, compliance with key laws and regulations and financial management (internal control).

Predetermined objectives

23. Material findings on the report on predetermined objectives, as set out on pages ... to ..., are reported below:

Non-compliance with regulatory and reporting requirements

24. There was no material non-compliance relating to the audit of performance information.

Usefulness of information

The following criteria were used to assess the usefulness of the planned and reported performance:

- Consistency: Has the municipality reported on its performance with regard to its objectives, indicators and targets in its approved integrated development plan, i.e. are the objectives, indicators and targets consistent between planning and reporting documents?
- Relevance: Is there a clear and logical link between the objectives, outcomes, outputs, indicators and performance targets?
- Measurability: Are objectives made measurable by means of indicators and targets? Are indicators well defined and verifiable, and are targets specific, measurable, and time bound?

The following audit finding relates to the above criteria:

25. The programmes included in the performance information of the municipality were found to be relevant for the purposes of this type of municipality; however they were not concise and specific.

Reliability of information

The following criteria were used to assess the reliability of the planned and reported performance:

- Validity: Has the actual reported performance occurred and does it pertain to the entity i.e. can the reported performance information be traced back to the source data or documentation?
- Accuracy: Amounts, numbers and other data relating to reported actual performance has been recorded and reported appropriately.
- Completeness: All actual results and events that should have been recorded have been included in the reported performance information.

The following audit finding relates to the above criteria:

26. The audit of pre-determined audit objectives and the usefulness of reported performance information revealed that the Integrated Development Plan (IDP) and Service Delivery Budget Implementation Plan (SDBIP) did not have target indicators that were specific and concise. These indicators and targets in the IDP were also not reported in the Annual Performance Report, for some of the programmes thus making it difficult to trace the reported performance information back to its original source data. Furthermore, due to the missing target indicators on the IDP and SDBIP, it was not possible to determine whether the data relating to reported actual performance had been recorded appropriately for certain of the programmes.

Compliance with laws and regulations

Included below are findings related to material non-compliance with the acts as indicated.

Municipal Finance Management Act of South Africa, No 56 of 2003 (MFMA)

Creditors not paid within 30 days of receiving the invoices

27. Contrary to the requirements of section 65(2)(e) of the MFMA, the municipality did not settle all payments due to creditors within 30 days of receiving the relevant invoice or statement. Payments, totalling R486 722 were identified in this regard.

No proper management, accounting, internal control and information systems are maintained

28. Contrary to section 63(2)(a) and (c) of the MFMA, the accounting officer did not take reasonable steps to ensure that the municipality has and maintains a management, accounting and information system that accounts for assets and liabilities of the municipality and that the municipality has and maintains a system of internal control of assets and liabilities, including an asset and liability register as assets could not be physically verified during the audit and not all municipal property was recorded in the asset register.

Internal audit was not effective

29. Contrary to section 165 of the MFMA, the internal audit unit was not effective due to the following:

Did not prepare a risk based audit plan in terms section 165(2)(a) as there was no formal internal audit methodology, there are no audit manuals or other similar documents, and there are no work programmes, including work performed on the performance information systems, controls and validations.

Audit Committee was not effective

30. Contrary to the requirements of section 166 of the MFMA, the Audit Committee was not effective throughout the financial year under review.

Monthly reports on conditional grants spending were not submitted

31. Contrary to the requirements of section 74(1), the accounting officer of the municipality did not ensure that the monthly reports or returns on their conditional grants spending for the period ended 30 June 2010 were submitted.

National Treasury was not informed of payments due by organs of state

32. Contrary to the requirements of section 64(2)(e) of the MFMA, the accounting officer did not immediately inform National Treasury of any payments due by the other organs of state to the municipality in respect of municipal tax and/or for municipal services amounting to R2,314,482. These organs of state are regularly in arrears for periods of more than 30 days.

Division of Revenue Act of South Africa, No 12 of 2009 (DoRA)

33. Contrary to section 11 of the Division of Revenue Act, No 2 of 2009, the accounting officer did not ensure compliance with the provisions of Division and Revenue Act due to the following:

- No certification was made by the municipality to National Treasury in respect of schedule 4 allocations.
- No public declarations were made of the conditions and information in respect of the allocations to facilitate performance measurement and the use of required outputs and inputs
- No annual evaluation of the performance in respect of the programmes had been done and submitted to the transferring officer.

INTERNAL CONTROL

34. I considered internal control relevant to my audit of the financial statements and the report on predetermined objectives as well as compliance with the MFMA, but not for the purpose of

expressing an opinion on the effectiveness of internal control.

35. The matters reported below are limited to the significant deficiencies regarding the basis for the qualified opinion paragraph, the findings on the report on predetermined objectives and the findings on compliance with laws and regulations.

Leadership

36. Oversight responsibilities over timeous capturing of pertinent information, systems documentation, reporting, compliance with laws and regulations and internal control are not exercised.
37. The accounting officer does not evaluate whether management has implemented effective internal controls by determining whether senior management has met its responsibilities.

Financial and performance management

38. Pertinent information is not identified and captured in a form and time frame to support financial and performance reporting.
39. The financial statements and other information to be included in the annual report are not reviewed for completeness and accuracy prior to submission for audit.
40. Pertinent information is not identified in a form and time frame to support financial and performance reporting. Consequently, the financial statements and performance information were subject to material amendments resulting from the audit.

Governance

41. The municipality is one of four municipalities that form part of the Shared Internal Audit Service (SIAS) division controlled the district municipality. The internal audit division was not effective in performing its duties and responsibilities as it was understaffed.
42. Due to this limitation and other factors, the shared service audit committee could not adequately discharge its duties during the year under review nor could they spend sufficient time engaging the municipality regarding internal controls and financial and risk management and could not exercise sufficient oversight over the implementation of the internal audit function. This contributed to the above findings mentioned in the preceding paragraphs under compliance with laws and regulations

Auditor General

East London

29 November 2010



AUDITOR - GENERAL
SOUTH AFRICA

Auditing to build public confidence